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States Flex Prosecutorial Muscle

Attorneys General Move Into What Was Once Federal Territory

By Brooke A. Masters
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Are drug companies using deceptive marketing? Connecticut is investigating.

Did mortgage financing giant Fannie Mae mislead investors? Ohio has filed suit alleging securities fraud.

Did mutual funds make improper payoffs to brokers? California brought a complaint against giant broker Edward D. Jones & Co. last month.

Are power plants contributing to global warming? Eight states have combined to sue to force big utilities to cut their emissions of carbon dioxide.

Americans once relied primarily on an alphabet soup of federal agencies -- SEC, FTC, EPA -- to protect investors, consumers and the environment. But state regulators and attorneys general are bringing legal action and launching investigations in these and other areas where they say federal regulators have fallen down on the job.

"Our action is the result of federal inaction," said Connecticut Attorney General Richard Blumenthal, who has brought actions against drug companies, polluters and the Environmental Protection Agency. "The [Bush] administration has not just failed to enforce the law, it has sought to undercut it and gut it. . . . States are filling the vacuum."

The trend is likely to accelerate in Bush's second term, analysts said, as Democratic state officials attempt to counter market-oriented approaches to issues such as drug safety, antitrust enforcement and the environment.

"If the administration's new appointees are perceived as being soft or less aggressive, it will encourage the state regulators to step in," said Henry T.C. Hu, a University of Texas law professor.

The motivation of state officials, analysts say, is both principle and politics -- 43 of the state attorneys general are elected, and analysts routinely refer to the nationwide attorneys general group as the National Association of Aspiring Governors.

In fact, New York Attorney General Eliot L. Spitzer, whose aggressive investigations of Wall Street and other industries have kept him in the spotlight, has announced that he is running for governor of New York. Critics call the recent spate of state actions "the Spitzer effect," arguing that other state officials are hoping to duplicate his success.

That prospect worries federal prosecutors and regulators who complain that the state initiatives sometimes complicate their efforts to punish lawbreakers and set workable national standards. "There is a legitimate role for state regulation of business in our federal system of government. However, a proliferation of conflicting state rules can create inefficiency and inflexibility in our national economy," said John D. Graham, head of the Office of Management and Budget's Office of Information and Regulatory Affairs.

Business groups argue that they are being hit with conflicting demands from ambitious politicians more interested in making headlines than consistent, viable policy.

"The overreaching of the state attorneys general is a problem that is growing," said Lisa Rickard, head of the U.S. Chamber of Commerce's Institute for Legal Reform, which sponsored a study last fall of class-action suits brought by attorneys general and may mount challenges to state actions it considers inappropriate. "They're trying to legislate and they are trying to regulate through litigation."

Activism is not limited to state attorneys general. State treasurers and the heads of state pension funds have been pushing big companies for corporate reforms. Although key environmental and banking cases are still pending, so far the states are doing well. Many corporate targets have settled and agreed to changes, and a federal judge ruled preliminarily for the states in one landmark clean air case.

"We are right on the facts. This isn't new regulation. It's enforcement of existing statutes," Spitzer said. Conservatives "pushed for federalism to begin with," he said. "They were trying to limit federal enforcement. They are now paying for the Frankenstein they created."

Spitzer recently predicted that he will need to bring fewer cases against Wall Street because the federal regulator, the Securities and Exchange Commission, has become more aggressive in the wake of his earlier probes.

Historians and policy analysts say the current activism was decades in the making. "Regulatory competition is as old as the Constitution," said Eugene A. Ludwig, who clashed and cooperated with state banking regulators as comptroller of the currency in the 1990s. "It's inherent in our form of government," which gives federal and state officials overlapping responsibilities.

In the 1970s, federal officials, acknowledging they couldn't do everything, gave grants to states to beef up consumer and investor protection. The flow of cash dried up after Ronald Reagan was elected president, but the bench strength built up in state legal offices didn't wither and die. Instead, states began cooperating and finding new targets. In 1984, six states in the Northeast sued to force Reagan's EPA to order pollution cuts, and 21 states teamed up to challenge a proposed settlement in a federal class-action securities fraud case in 1985.

Reagan and his successor, George H.W. Bush, also appointed judges who supported states' rights, arguing that Congress and federal regulators had overstepped their authority. Some of those same judges are now hearing the current crop of state lawsuits.

When Bill Clinton was elected president, his administration began bringing more federal environmental and antitrust actions. Most state attorneys general backed off or coordinated their actions with the federal government.

"It's cyclical. If you have an activist regulator at the federal level, it doesn't leave a lot of room for states," said Roger Noll, a Stanford University economics professor who studies regulation.

The dynamics changed again in the mid-1990s, when governors pushed for welfare changes and some state attorneys general sued the tobacco industry for consumer fraud. The tobacco settlement generated billions of dollars for state coffers and convinced even more state attorneys general of the advantages of working together.

"Twenty years ago, I did a bunch of [consumer protection] cases against local drugstores," said James E. Tierney, a former Maine state attorney general who now heads Columbia Law School's National State Attorneys General Program. "Today, what Rite Aid does in Lisbon Falls, Maine, Rite Aid does in San Francisco."

The tobacco lawsuits also introduced some state officials to a new resource: plaintiffs' law firms that work on contingency. New Mexico has used the tactic in environmental cases, and California's insurance commissioner this fall hired a class-action law firm to sue several insurance carriers over alleged kickbacks.

Many of today's activist state officials are Democrats who favor increased regulation, while the federal agencies are almost exclusively led by Republicans who favor free markets. Democratic California Attorney General Bill Lockyer has officially challenged the Bush administration nearly two dozen times, his office calculates.

Some attorneys general don't approve of the new activism. "Some [state officials] are forgetting that any time you announce you are investigating an industry, you cause the stock to drop, and you have real people, hardworking people, losing money," said Virginia Attorney General Jerry Kilgore (R). "We have to be careful and take a more reasoned and slow approach."

When more than a dozen state attorneys general -- led by Spitzer -- sued to block a Bush administration policy that allowed older power plants to upgrade without meeting new pollution standards, Kilgore organized a coalition of nine states on the federal government's side. "We need to expand our energy options. Virginia is a coal-producing state," he said.

The divisions aren't entirely along partisan lines. Northeastern Republicans have joined some of the environmental lawsuits, and Republican Attorney General Jim Petro of Ohio has sued Fannie Mae, alleging the mortgage funding giant's accounting methods misled and damaged his state's pension and insurance funds. The SEC's chief accountant has told Fannie its accounting was faulty, but the agency has not brought a case against the company. "We are not going to sit back and wait for the federal government where we perceive there is damage being done," Petro said.

As states have become more active, businesses have protested.

The power industry, for example, has fought lawsuits seeking new limits on carbon dioxide emissions -- often blamed for global warming -- something the Bush administration has declined to do. "Global climate change is an international and national issue that states and localities cannot effectively address," said Bill Fang, climate issue director for the utility industry's Edison Electric Institute. "The CO_2 lawsuits . . . are improper attempts to circumvent the federal legislative process and engage in judicial legislation."

Cynthia Bergman, an EPA spokeswoman, said in an e-mail that the agency differs from states in its approach. "States have the right to take action against a particular utility," she wrote. "But at the federal level, we prefer to require ALL power plants to reduce emissions, not just go after them one by one -- that process takes too long."

Drug manufacturers, too, are being hit with multiple state investigations, as well as product liability and consumer protection lawsuits. Recently they've started to argue in court -- sometimes supported by Bush administration lawyers -- that having Food and Drug Administration approval should protect them from many state lawsuits.

"Having a patchwork quilt of rules and regulation from many different states makes compliance challenging. That's why Congress has given FDA final regulatory authority," said Marjorie Powell, senior associate general counsel of the Pharmaceutical Research and Manufacturers of America.

Federal prosecutors and regulators worry that activist state officials might interfere with their own investigations. In 2003, Oklahoma Attorney General Drew Edmonds angered the Justice Department by filing criminal charges against WorldCom Inc. officials, including several who were cooperating with the federal government, and former chief executive Bernard J. Ebbers, who at that time had not been charged with wrongdoing.

Edmonds, a Democrat, said he jumped in because he feared the federal government would never charge Ebbers with fraud in connection with the firm's $11 billion accounting restatement. He said he had previously been frustrated by a federal investigation of the Oklahoma Corporation Commission in which the state's statute of limitations had lapsed by the time federal prosecutors announced they were not bringing charges.

After U.S. Attorney David N. Kelley of Manhattan flew to Oklahoma to meet with him, Edmonds agreed to delay his case. Ebbers has pleaded not guilty to all the charges.

Former EPA administrator Christine Todd Whitman, a Republican who also served as New Jersey's governor, says she can see both sides of the issue. "The federal government should set the broad basic standard, but if states can figure out better ways to do it for themselves, they should be able to," she said.

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